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WAR AND FINANCE IN RUSSIA

BY HIS EXCELLENCY, THE RUSSIAN AMBASSADOR,
HON. BORIS BAKHMETEFF.

Finance is unquestionably the most essential element in the material end of any warfare, and this occasion gives me the best opportunity to emphasize again the splendid help which this great country is giving at present to the Allies by financing their purchases. Experience has shown that the expenditures of war have increased year by year, the different nations being obliged to keep pace in their financial plans with the requirements, and gradually adapting their policies to the development of demand. The United States entered the war when the military operations in Europe had reached their full swing and when on the other hand financial resources had been greatly exhausted. This government, therefore, has had no opportunity for steady and gradual development of financial methods. At the outset this country had to face the necessity of organizing its national military mechanism on a scale adequate to present European practices. In addition, the general conjuncture imposed the necessity of undertaking the most extensive financing of all allied countries.

The United States was thus obliged to face from the very beginning an annual war budget of over twenty billion dollars, thus in the first year equalling the whole of the expenditure of any European country since the beginning of the war. A financial problem was thus set before the government and the people of this republic, which both in magnitude and spontaneity has probably never had a precedent in the history of state finance.

The solution of this problem depends not only on the ability and mastering of statemanship, but relies to the greatest extent on the willingness of the people to contribute to the success of the governmental undertaking. It is in the patriotism and in the readiness to carry the burden of increased taxation, to moderate individual consummation, and to respond with all possible means to the appeal of the government to support loans, that there lies the possibility of success. It is the united effort of democratic action that is de-

manded by democracy at war. It is the sacrifice of the people of the United States to the great cause of justice. I feel that I should avail myself of this opportunity to pay a small tribute to the patriotic exhibition of the people so manifestly exemplified in the success of the liberty loan.

Russia entered the war in August, 1914, at a period of economic prosperity which followed an epoch of financial and economic depression, caused by the Japanese War and the subsequent revolution of 1905. War and political troubles had shaken the welfare of the country by imposing heavy indebtedness and by disorganizing normal activities, but the resources of the country were so rich and their development so successful that in the seven years (1907-1914) Russia had fully recovered. Still more, it had reached an unprecedented state of welfare.

The Japanese War had cost Russia about three billion roubles. This new indebtedness had not only been fully "digested" by the country but it was possible to raise the state budget from about 2.4 billion roubles in 1908 to 3.4 in 1913 and it should be remembered that this immense increase was used greatly for cultural purposes and did not necessitate new loans. In fact for several years before the present war the budget had not only been balanced without deficit, but the Treasury was able to accumulate from the surplus an emergency reserve fund of about five hundred million roubles and in addition to diminish the indebtedness by paying off about two hundred million, thus lowering the total state debt from 9.05 billion roubles in 1910 to 8.85 billion roubles in 1913. A vast gold deposit accumulated in the Treasury. On January 1, 1914, there were one billion, seven hundred million roubles of gold in the vaults of the state bank, the total metal reserves including foreign liabilities surpassing two billion. The Russian gold reserve was thus the largest in Europe, the British being in 1915 about eight hundred million and the French one and one-half billion roubles.

However prosperous were the general conditions of the country it is clear that all the normal sources of revenue were inadequate to meet the requirements imposed on the Treasury by warfare,—and this, although the war in the first year did not actually require excessive disbursements. It is most interesting to follow the increase of the cost of the war in Russia. During 1914 the expenses were only about twelve million roubles a day. They reached about

twenty millions in 1915, increasing from thirty-five to fifty million in 1916. At present Russia is spending about fifty-five to sixty million roubles a day.

The low expenses of the first year of the war are to be explained by the fact that during this period the army was using war material previously accumulated, and forming the regular complement provisioned in the mobilization plans. On the other hand, due to the richness of Russia in victuals, there had been at that time no substantial rise in prices. Deficiency in food supply was felt only late in the second year of the war. It was one of the greatest mistakes of the old government not to have introduced food regulation at the very beginning of the military operations. How fortunate for this country to have adopted a policy of sane regulation at the very beginning of warfare. The expenses of war increased in measure later as new extensive orders had to be placed to cover deficiencies in ammunition and as there had to be met the increased cost of food, raw material and labor.

To cover the expenditures of war extraordinary financial measures have to be adopted. Of such there are three: (1) increased taxation; (2) loans; and (3) emission of bank notes. All of these three methods were used in Russia from the very beginning of the war.

Taxation. It should be remembered that at the very beginning of military operations regulations for complete prohibition were issued and the sale of alcohol and vodka suspended. This fact had the most beneficial result for the general welfare of the country and was of the greatest political and social consequence. But at the same time it caused a decided "gap" in the budget causing a loss of about one billion roubles.

Characteristic of the situation in Russia all throughout the war had been the fact that all increases in taxation had been only about sufficient to cover the expenditures of the civic budget. At the start it was necessary to cover the deficit due to the suspension of the sale of vodka. Later, one had to keep pace with the increasing expenditures, and this notwithstanding the fact that the progress of taxation had been very substantial. All taxes were practically raised: direct, indirect, excises and duties as well as the revenues from state monopolies. In some cases taxes were nearly doubled. Railway fares and postage were increased 25 per cent. New taxes

were imposed—an income tax, a tax on war super-profits, etc. Comparing the budgets of 1914 and 1917 we find that 566 million roubles were obtained by direct taxation in 1917 as compared with 206 million in 1914, the total levy of taxation amounting to 2.1 billion in 1917, as compared with 1.24 billion in 1914. In order to appreciate this additional tax burden one should take into account the loss of territory and the extensive reduction in the number of taxpayers, due to casualties amounting to many millions of men during the bloody first period of the war. Further taxes have been imposed since the revolution, principally in the line of direct taxation, and the civic budget increased to about 5.4 billion roubles, which, taking into account the elimination of the vodka revenue, means an increase of more than 100 per cent on the budget of the pre-war period. I wish to mention at this time that the country met this increase in taxation with a readiness to sacrifice and contribute. The war was exceptionally popular and notwithstanding the hate which all people had for the old régime and its government, the growth of taxation was met without murmur and with calmness.

The revenue of 5.4 billion roubles is to be confronted with a provision of 4.8 billion, representing the expenses of the civic budget. Thus about six hundred million roubles are left for war expenditures. But this amount, however great from the point of view of a civic budget, is insignificant when compared with the annual requirements of warfare, which amounts at present to more than twenty billion a year. Other measures, therefore, to meet the necessities of warfare had to be applied.

Loans. Already during the first months of the war, an internal loan was issued for an amount of 500 million roubles. It is an interesting recollection to state the difficulties which the government had to face at that time when raising a loan, although of such a small total. It has been an experience of this war, so far as I know characteristic of all of the countries, that with the progress of the war the raising of loans was getting more and more easy and one can surely state that more difficulty was encountered in raising the first 500 million roubles in 1914 than in the issuance of bonds of greater totals in the later periods. In 1915, three loans amounting to two and one-half billion, and in 1916, two loans with a total of five billion were issued. After the revolution a new liberty loan was

launched which amounted to about four billion roubles. The total amount of loans exceeded eleven billion and in addition, short term certificates were issued of which four to five billion roubles were purchased by the people.

Internal loans were followed by foreign loans, especially since 1915, when extensive orders were placed in foreign countries. The war suspended Russian exports and deprived the country of an active trade balance which had been sustained for many years. From several hundred millions of active balance (surplus), the country in 1915 was brought to a passive balance (deficit) of more than seven hundred millions, and in 1916 to one and one-half billion. It was absolutely impossible to cover such extensive foreign purchases by loans issued freely on the market. Financing on such a scale could be operated only through government channels.

This fact of inter-allied government coöperation in financing is another characteristic feature of the war. In 1915 certain agreements were made for mutual use of financial facilities by Great Britain, France and Russia. These arrangements later resulted in formal agreements between the allied governments which provided Russia with certain monthly allowances in foreign exchange to cover expenditures of foreign purchases, conditioned, however, by certain modalities to the effect that purchasing of foreign goods would be centralized to avoid competition and that certain regulations should be provided for, so as to attain an efficient and practical form of commercial transaction. The total amount of foreign war loans until April, 1915 was about five billion roubles. Out of that only 320 millions, or about 6½ per cent, had been obtained through loans issued on a free market; of this amount one-half was loaned by the United States.

Summarizing, one sees that about sixteen billion roubles were procured during the war through long term internal and foreign loans and about four million from short term certificates. This amounted to about 60 or 70 per cent of the actual expenditures of the war.

It proved impossible to draw out more funds from the people and to return to the Treasury a higher percentage of the moneys expended within the country. This, to a great extent, was due to the fact that a considerable amount of money spent has been distributed within the peasant class, the small cultivator who is unac-

customed to investments and often prefers to hold his money in specie. The increase of the wealth and the rate of money holding within the country is most interesting. At least 80 per cent of the war expenditures have been made within the country; as a result the people during the war have become tremendously rich as compared with the pre-war period. The total deposits in all the credit institutions of Russia have increased from 5.3 billion roubles in July, 1914, to 12.5 billion in January, 1917; and to illustrate in particular the increase of wealth among the peasants, one should recall that the deposits in the savings banks have more than doubled. Yet, as I have said, it was impossible to raise all the money necessary by credit operations, and the government was compelled to issue bank notes. This measure, however undesirable, is in most cases necessary in the process of warfare. All countries have to use this resource. Great Britain, probably, has used it least of all, France stands in between and Russia has used emission to the greatest measure.

Issue of Bank Notes. Before the war the Russian currency was excessively stable. As I have told you, the gold deposits of the state bank, the only emission institution in Russia, were about 1.7 billion roubles. The emission laws permitted an issuance of paper money to an extent of only three hundred million roubles above the gold deposit. In fact, under existing requirements of circulation, the emission law had never been fully used; the amount of bank notes being a little above 1.8 billion roubles, thus being guaranteed by the gold reserve to about 90 per cent of their par value.

Since the beginning of the war the emission law had to be changed and further issuance of bank notes was permitted. These issues were made by the state bank against short term certificates of the Treasury, the state bank formally purchasing the bonds of the Treasury. In reality, this operation represents an emission with a reduced gold reserve and of course resulted in an inflation with paper money and in a depreciation of the value of the rouble. The total amount of paper roubles issued until the beginning of this year exceeded eight billion, thus lowering the gold guarantee to a great extent. The inflation of the country with paper money created a great depreciation of the purchasing power of the monetary unit, such depreciation being greatly increased by the fact of an acute shortage of commodities.

This lack of commodities is perhaps the outstanding feature of the present economic crisis in Russia. The suspension of imports and the militarization of industry, turning all the productive capacity toward munition work and thus reducing the production of commodities, had deprived the market of every-day necessities. Boots, clothing, household articles, metals and all kinds of elementary and necessary articles were becoming scarcer and scarcer, and this resulted not only in an outrageous increase of prices, but offered as well the basis for social ferment.

When Kerensky spoke recently of the sacrifices which Russia is now enduring, he certainly had in view all the difficulties of life encountered at present due to lack of food, every-day commodities, transportation, etc., which in the long run result in deprivation and suffering. The inflation of the currency with paper money brought as a natural result an instability of the exchange rate of the rouble on the foreign markets. I would like to mention at this time, that the prevailing exchange rates on foreign markets throughout the war in no way correspond to the actual state of the economic and financial welfare of the country, but have been conditioned (especially lately) by political factors, or have been the result of the inappropriate financial policy of the old government.

In fact the exchange rate did not affect the actual purchase of foreign supplies, these being executed by the government using credits granted under inter-allied agreements. The exchange rate affected mostly private purchases, so far as these were not regulated and covered by moneys obtained through governmental loans. Unfortunately, one must admit that during the war the old government had not taken a strong policy of prohibiting unregulated imports, and thus encouraged all kinds of private financial arrangements between concerns in Russia and credit institutions abroad, particularly in America. These transactions in foreign exchange had the most depressing effect on the value of the rouble. It should be remembered that the lack of commodities allowed the importer to sell at exorbitant prices which would protect him against any possible loss in providing foreign exchange. Such were the reasons why transactions were accepted under preposterous conditions. The provisional government of the Russian Republic has fortunately suspended this policy and has adopted a strict and centralized regulation of imports, thus practically excluding the possibility of any

private exchange dealing, which under the present conditions would lose its attractiveness.

I have presented thus far a short outline of finance in Russia. The result seemingly does not appear cheerful. Due to the inflation of the currency with paper money, Russia is undergoing an acute financial crisis which is completed by disorganization in transportation, and a crisis in the production of commodities. While the total indebtedness of the country had reached about forty billion roubles in 1917, the debt will undoubtedly increase by next year to about sixty billions. With a shaken financial system, and a depreciated value of the rouble, such liabilities seem rather depressing and the conditions under which the present government has to carry the responsibilities of statemanship and conduct the great country in the path of its historical destiny seem rather discouraging. Nevertheless, I am not afraid to expose the situation openly and frankly, and this not only because I have faith in a policy of straightforwardness, but also because I face the situation with perfect calmness having the greatest confidence and hope. The financial difficulties, which Russia will have to meet, are similar to those which will have to be faced by all other countries, both allies and enemies.

The essential feature of the problem of the financial consequences of the war lies in the necessity of meeting a war expenditure incomparable to any normal civic budget. It is this financial burden, which is comparatively equal for all the great powers, which will determine the future financial policies of all countries. When compared to this main task it will be a factor of second importance, whether at the start a country faced a favorable situation caused by a sane and systematic policy of credit operations, or will have to contend with a shaken financial system due to inflation. However different may be the initial conditions, for a country as a whole, as a certain economic unit, the main problem will be to absorb and to heal, in the process of economic development, the incurred bruises of the expenses of war.

All possible methods of liquidating the consequences of warfare do result in raising the state revenue. Increased state revenue involves eventually an increase in the amount of taxation and this means that a greater part of the income of the nation, of the output of the national production, has to be turned to the state for disposal.

As it is impossible to extend the pressure of taxes above a certain reasonable amount as compared with the national income, the only way to solve the question is to amplify the national production as such. It is therefore in the development of national production, in the expansion of economic activities, in the growth of the national output, that there lies, in the long run, the solution of the financial problems imposed by the consequences of war.

When determining, therefore, how a country will be able to meet the future situation, consideration should be given, first of all, to the possibilities of economic development and to the prospects of an increase of national wealth. This is a process, and a process of considerable duration. It should be considered as such and any occasional occurrence or situation should not be overestimated. In the long run, in the process of liquidation, the conditions in any country can change, political, economic and social; it is the potential possibilities of a country which should be taken into account and from this point of view a country, feebly developed, has even a certain preference over a country "economically saturated," that is, a country in which the existing relations between natural resources, labor and general conditions of economic activities have reached a conjuncture of intensity to exceed which is not permitted by the general balance of world competition.

It is from this aspect that one should value the present financial situation in Russia. The latent riches in Russia are well known. A country of practically unlimited territory, bountiful in natural resources, with an abundance of labor provided by an industrial and clever population, the efficiency of which has been hampered only by a lack of education, a country of excessively low economic "saturation," it is ready for the most spontaneous and intensive development. I would compare Russia to a youthful organism, promptly healing the heaviest wounds of economic and political disorganization.

One should recall the experience of the short period between the two wars (1907-1914), when progress was brought into Russian life by the establishment of the Duma, the first national representative institution in Russia. Of course, there can be no comparison between the financial problems of 1907 and those of 1917, but one should remember that in 1907 Russia was the only European country which had to deal with the financial consequences of a war, and

I recall how unsurmountable seemed to be to the people of Russia the financial problems which the country had to meet.

To illustrate what has been performed during the last decade, I will take two or three examples: the annual production of pig iron from 1904 until 1914 increased in Russia from 180 to 283 million poods, thus giving an increase of 60 per cent. The production of coal had nearly doubled. As to cotton, only sixteen million poods were used in Russia in 1905, of which ten were imported and six produced within the country. In 1916 the country consumed twenty-eight million poods, of which only seven million were imported. The joint stock of the banks had reached 632 millions in 1916 as compared with 237 in 1910. But nothing can serve better to evaluate the economic development of a country and to show its recuperative abilities than the rate of increase of the state budget. I will compare for example the growth of the state budgets of France and of Russia for the last fifteen years. If we take 1897 and 1912, that is a period of fifteen years, we see that the state budget of France has grown from approximately 3.4 billion francs to 4.5 billion, that is about 30 per cent. During the same period the Russian budget increased from 1.4 billion to 3.0 billion roubles. That is an increase of 210 per cent.

Therein lie the healing capacities of my motherland. You Americans have gone through a period of economic and political depression, when your country seemed on the verge of ruin but afterward entered upon the greatest period of economic development ever witnessed in the history of the world. I mean the Civil War, with all its bank notes, the depreciation of the currency, the disorganization of regular economic activities, and the ensuing period of unsurpassed development which brought this great country to its present state of unlimited wealth and unbounded economic capacity.

Russia, freed of the tentacles of despotism, free from restrictive and prohibitive legislation; Russia, literate and illuminated, with complete opportunity given to individual enterprise, will be easily healed of all the wounds and sores of the present political upheaval and economic crisis and will settle in the firm forms of a democratic commonwealth with an unprecedented development of her economic resources. The experience of history, the knowledge of the character of the country and of the spirit of the people give me confidence and faith in the future.